An Accountant's Defining Moments: Questionable Corporate Practices Before & After the Sarbanes-Oxley Act of 2002

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Abstract

The image of corporations that were once held in high regard because of their power and profits has been damaged recently by alarming news stories about dishonesty and corruption at their highest levels. In an effort to address public concerns brought about by the dominant headlines of Enron, WorldCom, Xerox, Andersen, Adelphia, Tyco, and Global Crossing, among others, Senator Paul Sarbanes and Congressman Mike Oxley were instrumental in developing a host of laws to strengthen corporate accountability. Signed into law by President George W. Bush on July 30, 2002, the bill, the Sarbanes-Oxley Act of 2002, among other things creates an oversight board to monitor the accounting industry, toughens penalties against executives who commit corporate fraud, and increases the authority and funding of the Securities & Exchange Commission (SEC).

For the purposes of this study, a survey of accounting professionals was conducted. Using the survey results, this article will address issues in corporate America surrounding fraud, waste, and abuse by business leaders, and the concealment of such by the accountants charged with keeping them in check. The article also addresses issues and considerations leading up to the Sarbanes-Oxley Act of 2002 and the new rules for corporate accounting and reporting in America.

Introduction

Headline news stories about fraud, waste, and abuse from the highest levels in corporate boardrooms continue to fill the airwaves and are plastered on the front pages of newspapers from coast to coast. The stocks of these publicly held corporations, once regarded as "blue-chip," are now listed as nothing more than "penny-notes." Finger pointing among corporate leaders (and their accountants) is rampant.

The list of companies is long and growing longer, with investors wondering if there is an end in sight. It is drawing near for some, as government agencies, including the Federal Bureau of Investigation (FBI) and the SEC, are investigate irregularities, and the Department of Justice (DOJ) lodges criminal indictments against corporate leaders who acquired personal gain at the expense of investors.

As the public hears the initial reports (and cringes if owning the named stock), they inevitably ask the following questions:

- How could this have happened?
- Where is my money?
- Where were the auditors, and who are they?
- Why didn't they catch this, or see it coming?
- Didn't they follow the accounting procedures?
- Who audits the auditors?
- Where is justice?

In response to what appears to be an epidemic, Senator Paul Sarbanes (D-Maryland) and Congressman Mike Oxley (R-Ohio) developed a host of new laws to strengthen corporate accountability. Signed into law by President George W. Bush on July 30, 2002, the Sarbanes–Oxley Act creates an oversight board to monitor the accounting industry, toughen penalties against executives who commit corporate fraud, and increases the authority and funding of the SEC. In signing the law, Bush said, "No boardroom in America is above or beyond the law" (The White House, 2002 July 30). Under the act, a CEO or CFO will be called upon to certify his or her company's financial reports. Those that lie can be tried and sentenced for up to 20 years, and be fined $5 million. The law calls upon accountants to be regulated by a board, and requires ethics in their conduct, as well as certain practice standards, including submitting to audits of their audits.

The changes of this new anti-fraud law should bring about a dramatic turnaround in the accounting field, providing scrutinized regulation to an industry that has been largely flawed and self-regulated. So, how bad is it? That is, what were the practices of accountants before the line was drawn down the middle of the ledger by the Sarbanes–Oxley Act? Are there other corporations yet to fail? Were General Accepted Accounting Principles (GAAP) circumvented? Does corporate America have a grip? How will the new law help, or will it?

To answer these, and other questions, a research questionnaire was designed and dispatched to a random sampling of 1,783 of the approximately 56,000 Certified Public Accountants (CPA) holding licensure in California. While fraud surveys have been conducted in the past, they have dealt with issues of dishonesty at lower operational levels. This survey was designed to test the degree and scope of questionable business practices in corporations, where accounting professionals have been solicited by the CEO, CFO or other corporate management to circumvent GAAP. The survey was also written to assess anticipated compliance by the accounting profession with the terms of the Sarbanes-Oxley Act.

Questionable Corporate Accounting Practices

Each week on the television series *Law & Order* the show begins with the police being called to the site of a violent crime. The plot then moves through the investigation, the arrest, and the trial of the perpetrator. A recent episode revolved around a corporate executive being prosecuted for arranging the murder of an employee who was planning to "blow the whistle" about the manipulation of his company's financial records. It is often said that television programming is a reflection of society. While corporate murder plots were not part of Congress's reasons for passing recent corporate finance reform, the manipulation of financial records is at the heart of the legislative intent of the Sarbanes-Oxley Act.

The Sarbanes-Oxley Act is aimed at improving corporate responsibility in the wake of business failures such as Enron, WorldCom, Xerox, Andersen, Adelphia, Tyco, and Global Crossing, among others. The amount of media attention on these issues has been huge. Two elements have captured most of the attention. First are executives making millions of dollars on stock options and bonuses of their soon-to-fail companies. Second are accountants who have "cooked the books," by using questionable (or highly aggressive) accounting methods to make a company appear more valuable in the marketplace.

What has not emerged from public discourse, however, is empirical data to demonstrate if there is actually an increase in questionable business practices involving the circumvention of GAAP in order to make a company's value appear more than it is. If there is such an increase, who is responsible for it? Are accountants being directed by company executives to find ways to make the balance sheets look better? This article attempts to provide quantitative data on these issues through a systematic sample of licensed CPAs in California.

Before the events unfolding in the Enron scandal, Arthur Andersen (Andersen) was one of the biggest and most respected accounting firms in the United States. As a member of the "Big Five," the nickname given to the group comprised of Andersen, Deloitte & Touche, PricewaterhouseCoopers, KPMG, and Ernst & Young, Andersen acted as the external auditor for many of the largest companies in the world.

The function of an external auditor is to " ... examine the financial statements prepared by management and determine if they were prepared according to the GAAP," says Robert Minnear, a retired audit partner of Deloitte & Touche and a senior lecturer at Emory University's Goizueta Business School (Luke, 2002). The GAAP is set by the Financial Accounting Standards Board (FASB), a private organization whose mission is to set accounting standards for such things as revenue recognition and financial reporting (Federal News Service, 2002, p.5). Minnear continues, "An auditor's responsibility isn't to detect financial irregularities or fraud" (Luke, 2002).

GAAP provides the fundamental rules for what is booked as revenue, what is booked as other income, and what is booked as an expense, but there are always situations that do not fit clearly into the guidelines. Those situations seem to be the most problematic to accountants and auditors.

Edmund Jenkins, Chairman of FASB, explained in a May 2002 Congressional hearing, "Auditors examine the financial reports of enterprises to determine that GAAP has been properly applied. Auditors also must assure that the stated intent of the standards are followed" (Federal News Service, 2002, p. 6). Jenkins also explained that his organization has no power of enforcement or authority in the regulation of accounting issues in the financial reporting process. Responsibility for ensuring that financial reports comply with accounting standards rests with the officers and directors of the reporting enterprise, with the auditors of the financial statements, with public companies, and ultimately the SEC (Federal News Service, 2002, p. 6).

These comments would make one think the only thing a CPA does is "rubberstamp" the results of a company's internal auditor - after checking a few figures. Unfortunately, this may not be too far from the truth. Jenkins, commenting about the situation at Enron and other companies which have been forced to restate their earnings, said, "In my opinion, the most efficient and effective accounting standards imaginable, and the highest quality accounting standards conceivable could not have prevented the Enron bankruptcy, could not have prevented the many corporate restatements of recent years, and could not alone improve the credibility of financial reports" (Federal News Service, 2002, p. 7).

On the other side of this argument, does this mean an accountant is not at all responsible for examining records for potential fraud or other problems that may translate to inaccurate information being placed into the marketplace? Robert Herdman, Chief Accountant for the SEC, says "No," and discusses one of the most important cases concerned with this issue. "One of the federal courts handed down a ruling in the case *United States v. Simon* in which the decision was that just because financial statements comply with all the measurement requirements of GAAP it is not an absolute defense if the result as well as the disclosures about it are misleading" (Federal News Service, 2002, p. 13).

While Enron and WorldCom may have received much of the initial media attention because of their sudden fall from market favorites to bankruptcy court, other companies may be doing much the same. In the latter part of January 2002, the stocks of Tyco, Cendant, Williams Companies, PNC, Elan and Anadarko were brutally punished for acknowledged accounting issues (Serwer, 2002). Some companies such as IBM Corporation and General Electric Company, fearing media attention and shareholder backlash, have voluntarily amended some of their accounting practices (McClearn, 2002). As Andy Serwer stated in his article in the February 18, 2002 issue of *Fortune Magazine*, "Yes, Enron may have been a 'rogue operation,' but its collapse has forced us to shine a 'halogen light' on the books of America's public companies, and what we're seeing sure isn't pretty" (Serwer, 2002, p. 74)

Virtually every investor in the market has been hurt financially by corporate failures or financial restatements. Significant accounting issues have caused each of these. Beyond the investors, there are thousands of people who worked at Enron and other businesses who lost most or all of their 401(k) savings. Former SEC Chief Accountant Lynn Turner estimates there has been a loss of more than $100 million that can be "directly attributed to losses due to financial restatements" (Serwer, 2002, p. 74).

The success of U.S. capital markets hinges on transparency in the financial reports of the public companies on the exchanges. Investors must understand the full picture of a company's value and risks (Litan, 2002). The effect of tremors in the U.S. market on foreign capital markets is growing due to the expansion of foreign operations and subsidiaries with U.S. based parent companies (Grossfeld, 2002).

There is one additional issue in the current accounting scandals that bears discussion: business consulting services being provided to a company by the same accounting firm that acts as its external auditor. Once again, the Enron/Andersen case has brought this issue to the attention of the public. Andersen had been providing a significant amount of consulting services to Enron. During a recent Congressional hearing, Bevis Longstreth explained about the "conflicts of interest" inherent in an accounting firm providing both audit and consulting services. Longstreth's credentials include service as a former partner with the New York law firm DeBevoise & Plimpton, four years as a Commissioner for the SEC, and as an instructor at the Columbia Law School. He also served on the Public Oversight Board's Panel on Audit Effectiveness. Longstreth said at a congressional hearing on WorldCom's Accounting Error in 2000,

> I'm going to invite you to consider two notorious fictions that for years leaders of the auditing profession have staunchly maintained, and thereby have deflected efforts over the years at any serious reform. The first fiction . . . is the claim that payment by an audit client to its auditor for consulting and other non-audit services, no matter how large, will 'never impair independence.' That is, it will never have an adverse effect on the quality of the audit or be seen to have such an effect in the eyes of the investing public. The second fiction . . . is that the 'accounting industry' can successfully self-regulate (FDCH Political Transcripts, July 8, 2002, p. 50).

To really understand the magnitude of the revenue made by accounting firms for non-audit functions, Longstreth continues, "Because of the SEC rule that required a separate disclosure of audit and non-audit fees paid to its auditor, the public has recently discovered how important non-audit fees have become to an auditor's bottom line. On average in 2001, non-audit services represented an astounding 73% of total fees paid to auditors by their audit clients" (FDCH Political Transcripts, July 8, 2002, p. 50).

The conflicts of interest seem incredibly clear. Management's purpose in hiring a consulting firm is to increase the bottom line. Moreover, since nearly three-quarters of an accounting firm's revenue comes from non-audit functions, their bottom line could be threatened if the consulting services were to cease. As such, it does not take much imagination to see that the "independence" of the audit function is easily compromised. Add to that the fact that the senior management of a consulting firm is often compensated for the overall financial performance of the firm, and the potential for tainting the independent audit becomes even greater.

The Need for Accounting Reform

In light of the growth of "restatements of earnings" and "conflicts of interest" by public companies, what can be done to restore transparency to financial recording? To answer that important question, Longstreth in his testimony to Congress said,

> To address the conflicts of interest that are amassed by these two fictions, reform is necessary. And I'm not a great believer in writing a law to solve every ill. In fact, I'm a great believer that that's a mistake. But I am convinced that legislative reform, and nothing short of legislative reform, will be required to meet this need, because the profession has been enormously effective in overwhelming efforts to reform by the SEC and others (FDCH Political Transcripts, July 8, 2002, p. 51).

Others have delivered the same message. For example, Bala Dharan, Ph.D., from the Jesse H. Jones Graduate School of Management, also testified before Congress regarding the ability of the accounting industry to self-regulate through efforts such as the FASB. He stated that self-regulation was not possible because the FASB deals with accounting rules – not enforcement (FDCH Political Transcripts, July 8, 2002).

Fortunately, after much investigation, testimony, and development, reform has been achieved in the form of the passage of the Public Company Accounting Reform and Investor Protection Act, short-named the Sarbanes-Oxley Act of 2002. This act requires the following:

- Establishment of a Public Company Accounting Oversight Board with certain empowerments on auditing and investigation. CPA firms must register with the Board and pay fees annually;
- Prohibition of CPA firms that perform audits from performing non-audit services for that client. This includes bookkeeping or other services related to accounting records, financial statements, financial information systems design and implementation, appraisal or valuation services, actuarial services, internal audit outsourcing services, management functions or human resources, broker or dealer, investment advisor, or investment banking services, legal services and expert services unrelated to the audit (Accounting Office Management & Administration Report, 2002);
- Prohibition of public companies from making loans to or arranging loans for its corporate officers and directors (Geisel, 2002);
- Dramatic changes to the way in which public companies hire and fire their external auditors by placing the authority solely with the audit committee (Holiday, 2002);
- Establishment of a new criminal statute which, " . . . prohibits fraud in connection with the purchase or sale of securities registered under Title 12 of the Securities Exchange Act of 1934" (Grunfeld, 2002, p. 9);
- Enhancement of existing criminal penalties for obstruction of justice and expansion of obstruction of justice to include destruction of documents that result in impeding a federal investigation (Grunfeld, 2002);

- That CEOs and CFOs return any compensation if the company's earnings are restated due to "willful non-compliance" of reporting requirements (Grunfeld, 2002);
- That foreign entities trading on U.S. markets comply with certain requirements of the Sarbanes-Oxley Act (Sawers, 2002).

The Sarbanes-Oxley Act leaves implementation and interpretation details to the SEC and other boards, such as the New York Stock Exchange, North American Securities Dealers, and the FASB. However, it is clear that legislators learned their lessons from the accounting debacles of the 1990's, which led to the Savings & Loan crisis, and the ultimate $200 billion Congressional bailout of the industry. In that case, too many specifics were left to the boards, which ultimately failed to reform the practices that led to the crisis. In this round of accounting changes, Congress clearly spells out a number of changes and charges the boards with the responsibility of implementing them.

The Study

Inspired by the passage of the Sarbanes-Oxley Act to address scandals surrounding the accounting industry, this study was designed to investigate questionable accounting practices and explore the implications of the new laws designed to restore corporate compliance. The hypotheses being tested were:

- The degree and scope of questionable corporate business practices are prevalent, because of accounting professionals' compliance with requests from CEOs, CFOs, or others to find ways to circumvent (or aggressively push) GAAP to make corporate earnings appear more valuable.
- The Sarbanes-Oxley Act will result in substantial changes to the accounting profession.

To test these hypotheses a self-administered questionnaire was sent, in a hardcopy format (as opposed to computerized), to a sample of California-based CPAs. California was chosen because many U.S. companies have their operating headquarters in the state and a sample of licensed individuals was easily obtainable.

The hypothesis states, "The degree and scope of questionable corporate business practices are *prevalent*." Webster's Dictionary defines prevalent as that which exists, happens, etc. over an area; common; general. Arguably, the term *prevalent* might be assigned a numeric value such as 50%, 75%, or 90%. In the research design used here the respondents could choose to answer both or either of the following questions:

- Within the last 5 years have you been solicited by a corporate client to *circumvent GAAP*? or
- Within the last 5 years have you been solicited by a corporate client to *aggressively push GAAP* (to the limits)?

The first question directly asks the respondents if they have been asked to be dishonest, while the second asks if they have been asked to be aggressive (or creative, without crossing the line of being dishonest) with accounting principles. For the purpose of this research study *prevalent* for the *Circumvent GAAP* question is numerically defined at 33% affirmative responses, and for the *Aggressively Push GAAP* question at 50% affirmative responses. The numeric value assigned to the *prevalence* of substantial changes in the accounting profession is 50% affirmative responses.

Method of Data Collection

As described earlier, a survey was used to test the hypotheses. The closed-ended, self-administered questionnaire was mailed, along with a cover letter explaining the research project. Subjects were asked to help with this study by answering two self-describing questions and 16 questions to test the two-pronged hypothesis. (See Appendix 1 and Appendix 2.)

The two self-describing questions ask for the individual's status in the firm in which he or she is employed and the number of years he or she has worked as a CPA. The other 16 questions are divided into three categories regarding solicitation to circumvent GAAP, solicitation to aggressively push GAAP, and the Sarbanes-Oxley Act. Questions in the solicitation category include position of the requestor, company type, company size, compliance, and additional circumvention request. Questions asked about the influence of the Sarbanes-Oxley Act include influence upon respondent's accounting practice, influence upon corporate confidence, influence upon investor confidence, and the necessity of the Sarbanes-Oxley Act.

Sampling Design

To test the hypothesis and collect the necessary data for this research project, the closed-answer, self-administered questionnaire was dispatched to a sampling of 1,783 CPAs licensed in the state of California. A systematic sampling procedure was implemented. Out of approximately 56,000 CPAs who are licensed and are listed in good standing with the state of California, every 30th name was randomly selected using a computer program. This resulted in the total sample size of 1,783.

Reliability and Validity

The value of this research project's results is contingent on meeting standards of validity and reliability. These are probably the two most important components in any type of scientific or social scientific research. Reliability refers to the ability to reproduce or repeat the results of a specific research project. By presenting all subjects with a standardized questionnaire, the study attempted to eliminate unreliability. For instance, the questionnaire appears to have measured the indicators conceptualized by the researchers. Nevertheless, the researchers did not provide specific definitions of the concepts, as the conclusion was reached that the specific terms were very common in both the accounting profession and the general business world.

Careful attention to cause-and-effect relationships are important factors in conducting valid research. As O'Connor (2002) explains, most surveys are cross-sectional, meaning that they ask a question of people only at one time. With no indication of past or prospective behavior information, researchers are limited in their ability to analyze the direction of causal relationships. However, as the researchers noted and have reason to believe, this study is the first to gather data regarding the degree and scope of GAAP circumvention and the potential effect of the Sarbanes-Oxley Act on the accounting profession. Hence, to truly test the validity of these results, it will be necessary for other researchers to test the same hypothesis using other methodologies.

Ethical Concerns

While this research project used a systematic sampling of 1,783 California CPAs to select potential respondents, every effort was made to provide complete anonymity. As such, each completed questionnaire is generic and cannot be attributed to any specific individual. The questionnaire was designed to be completed within a few minutes and, upon completion, to be placed into the U.S. Mail and sent to a postage-paid address. Upon receipt of the returned questionnaires, each was coded numerically 1, 2, 3, etc., to allow for research reliability and validity, as well as for sorting and ease of organization. The questionnaires have been retained for subsequent review or analysis.

Survey Findings and Discussion

The response rate for this research project is 32% -- 584 responses from 1,783 California CPAs. According to Maxfield and Babbie's review of the literature regarding response rates, "A response rate of at least 50 percent is adequate for analysis and reporting. A response rate of 60 percent is good. And, a response rate of 70 percent is very good" (2003, p. 261). If these numbers are considered benchmarks, the issue of response bias may need to be examined prior to forming any conclusions about a wider population of CPAs. However, Maxfield and Babbie also state that "these are only rough guides; and have no statistical basis" (2003, p. 261). Therefore, although 32% for this research project may not be adequate for response rate purposes, for an exploratory research project and large sample frame, the information gleaned from the respondents is extremely valuable.

Self Defining Attributes

The survey asks two self defining questions, which are designed to provide a baseline in understanding: (a) the respondent's position in the firm (b) the tenure as a CPA. A total of 379 (65%) are firm partners (this number also includes 11 respondents describing themselves as owners), and 205 (35%) are firm associates. One half of respondents, totaling 290, described themselves as tenured CPAs with 20 years or longer in the profession.

Figure 1. Firm Position

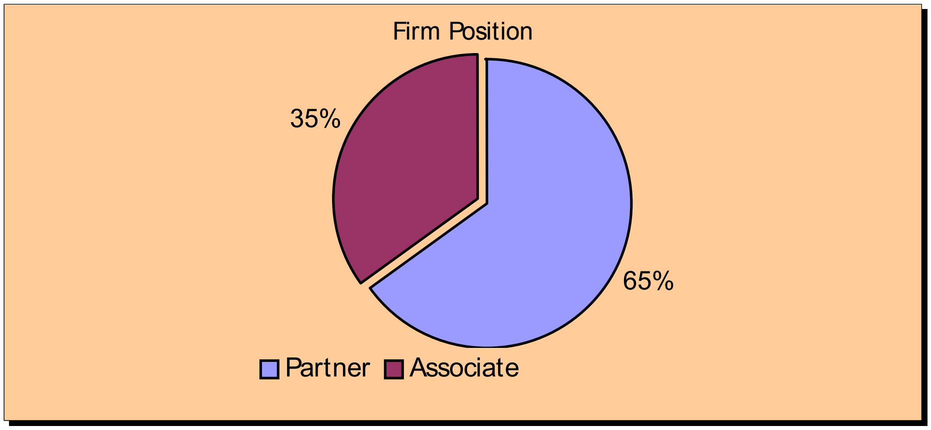
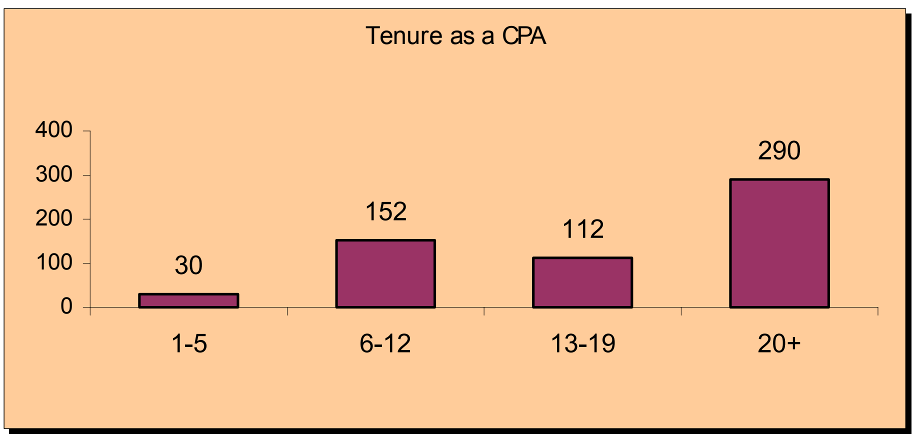


Figure 2 also shows other categories of the number of years as a CPA: 30 (5%) in the 1-5 years category, 152 (26%) in the 6-12 years category and 112 (19%) in the 13-19 years category.

Figure 2. Tenure as a CPA

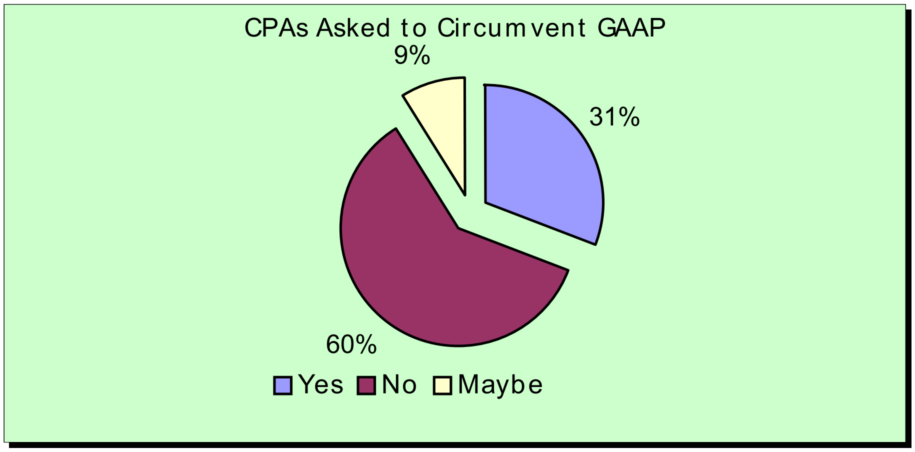


The majority of respondents are of the highest firm status and in the highest category for tenure. This may present issues of survey bias for future studies. It is important to note this when making any conclusions about considering a wider population of CPAs (in California or other states), for future studies, as the respondents may not identically mirror the population.

Solicited to Circumvent GAAP?

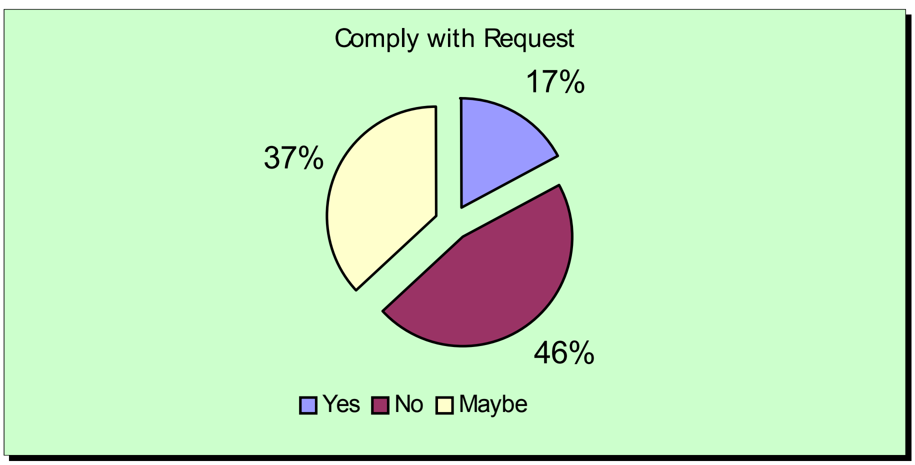
Respondents were asked if they had been solicited to circumvent GAAP standards. It is interesting to note that 180 professional CPAs (31%) revealed that within the last five years they had been directly solicited to circumvent (violate) the standards and rules which have governed the accounting profession for decades.

Figure 3. CPAs Asked to Circumvent GAAP



An additional 52 (9%) revealed that they might have been solicited. The combined total of direct and indirect solicitation totals an alarming 40%.

Figure 4. Comply with Request to Circumvent GAAP

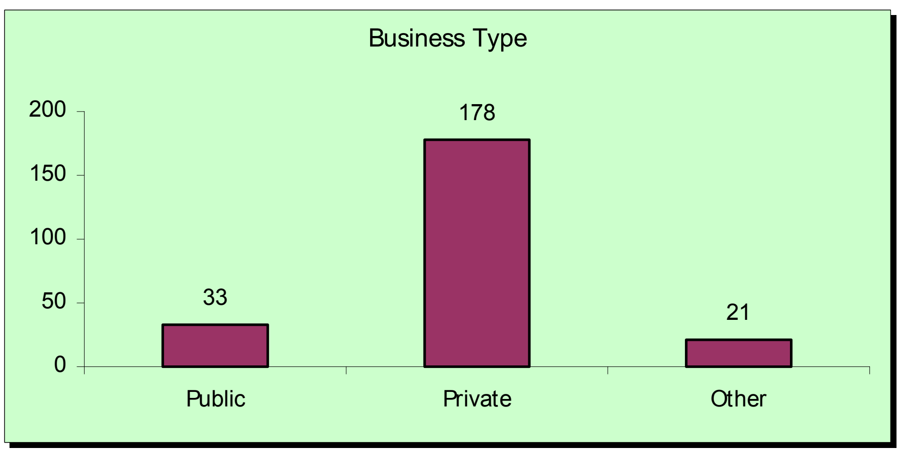


It is also alarming that 40 of the CPAs (17%) confess that they complied with the request and circumvented GAAP standards. An additional 86 (37%) admit that they may have complied with the requests to circumvent GAAP standards. This does not support the hypothesis that the scope of questionable corporate business practices are prevalent, as the study defined prevalence for the circumvention of GAAP question at 33% affirmative responses. However, if the number of direct and indirect solicitation and compliance with the request are totaled, it appears the results are close to what the researchers had expected.

Figure 5. Request by Position to Circumvent GAAP

Figure 5 shows the request by positions. Of the 232 respondents who revealed direct or indirect solicitation, the primary corporate representative making the request was the Chief Executive Officer on 94 occasions (40%) and the Chief Financial Officer on 86 occasions (37%). The remaining 23% included the Corporate Counsel and Comptroller. These results support the hypothesis that top corporate leaders usually solicit direct or indirect circumvention of GAAP.

Figure 6. Business Type



The overwhelming majority of these companies, 178 or 77%, are private corporations, while 33 (14%) are public corporations. The remaining 9% are non-profit organizations or governmental bodies. This is interesting, considering that the Sarbanes-Oxley Act *only addresses* publicly held corporations. These results show that a need exists for investor protection for private corporations too.

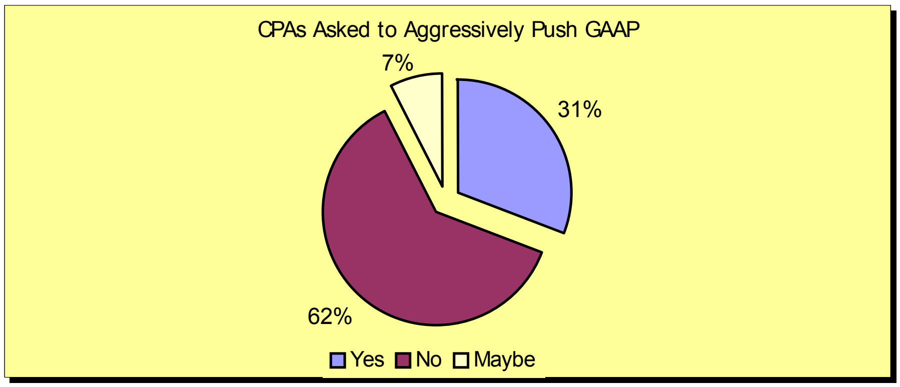
Two hundred and seventeen of the respondents (92%) report their company size to be less than 1,000 employees. A closer review notes that 46% have fewer than 100 employees and 46% have between 100-999 employees.

Was there more than one solicitation request? Yes, 40 respondents (17%) admit that requests for them to circumvent GAAP standards occurred on more than one occasion.

Solicited to Aggressively Push GAAP?

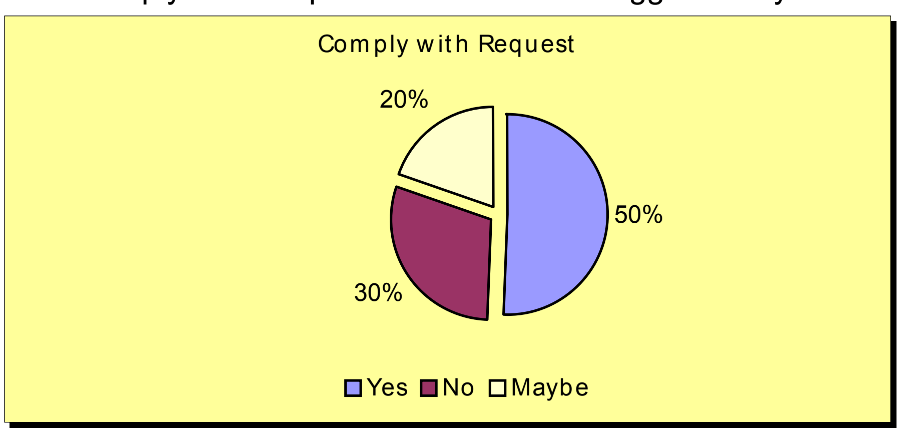
Respondents were also asked if they had been solicited to aggressively push GAAP standards. It is interesting to note that 180 (31%) revealed that within the last five years they had been directly solicited to aggressively push the standards and rules which have governed the accounting profession for decades.

Figure 7. CPAs Asked to Aggressively Push GAAP



An additional 43 (7%) revealed that they might have been solicited to aggressively push GAAP. The combined total of direct and indirect solicitation is an alarming 38%. While the number to circumvent and the number to aggressively solicit totals 180 each, the respondents are not necessarily the same 180. Some responded to both affirmatively, yet others responded to one or the other. Nevertheless, the result shows a similar response for the number of both direct and indirect solicitations of circumventing GAAP standards and for aggressively pushing GAAP (40% vs. 38%).

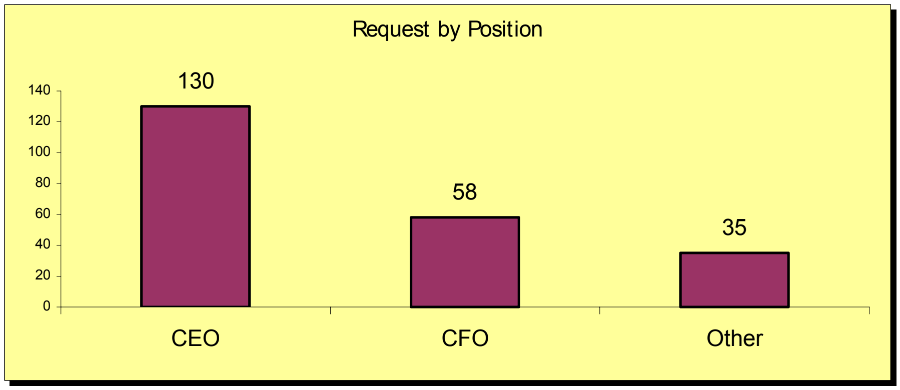
Figure 8. Comply with Request When asked to Aggressively Push GAAP



Did the respondents comply with the solicitation to aggressively push GAAP standards? Yes, a total of 113 respondents (50%) reveal that they aggressively pushed the standards for a client. This supports the hypothesis that the scope of questionable corporate business practices is prevalent at the operational definition of compliance with the request to aggressively push GAAP at 50% affirmative responses. When results were compared to the response of complying with the request to circumvent GAAP, the study found a big difference in affirmative responses (17% vs. 50%). An additional 44

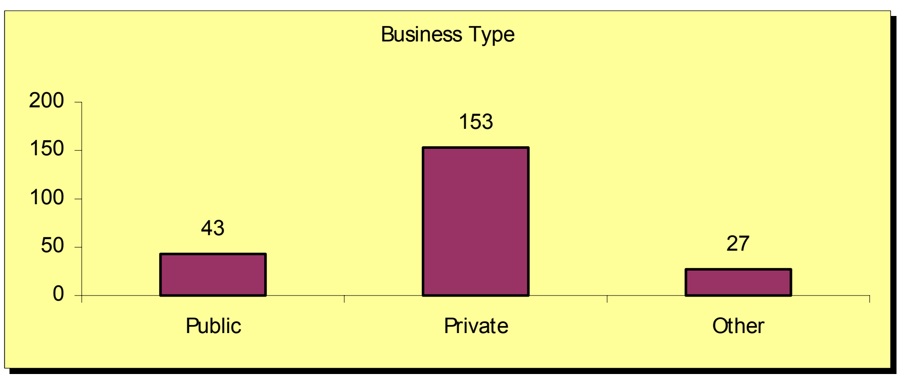
(20%) suggest that they may have complied with the request to aggressively push GAAP standards.

Figure 9. Request by Position to Aggressively Push GAAP



Of the 223 respondents who revealed direct or indirect solicitation, the primary corporate representative making the request was the Chief Executive Officer on 130 occasions (58%) and the Chief Financial Officer on 58 occasions (26%). The remaining 16% included the Corporate Counsel, Comptroller and Accounting Manager.

Figure 10. Business Type



The overwhelming majority of these companies, totaling 153 (68%), are private corporations and 43 (19%) are public corporations. The remaining 13% are non-profit organizations.

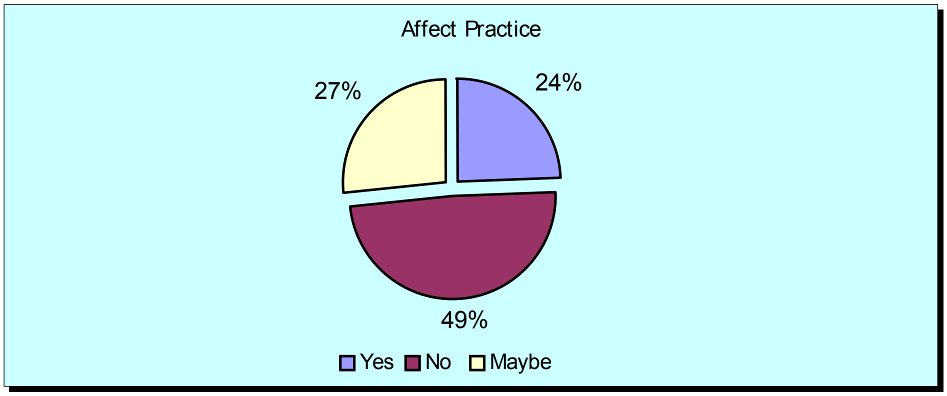
Respondents totaling 217 (97%) report that their companies employ less than 1,000. A closer review notes that 67% have fewer than 100 employees, while 30% have between 100-999 employees. Again, these results show a need exists for investor protection for private corporations too.

Was there more than one solicitation request? Yes, 79 respondents (35%) admit that requests for them to aggressively push GAAP standards occurred on more than one occasion.

Questions Regarding the Sarbanes-Oxley Act

Respondents reported a varied understanding about the Sarbanes-Oxley Act and how the new law will affect their practice. One hundred and forty three respondents (24%) believe the new law will affect their practice, while 286 (49%) do not believe the law will have any effect.

Figure 11. Influence of the Sarbanes-Oxley Act on Accounting Practice

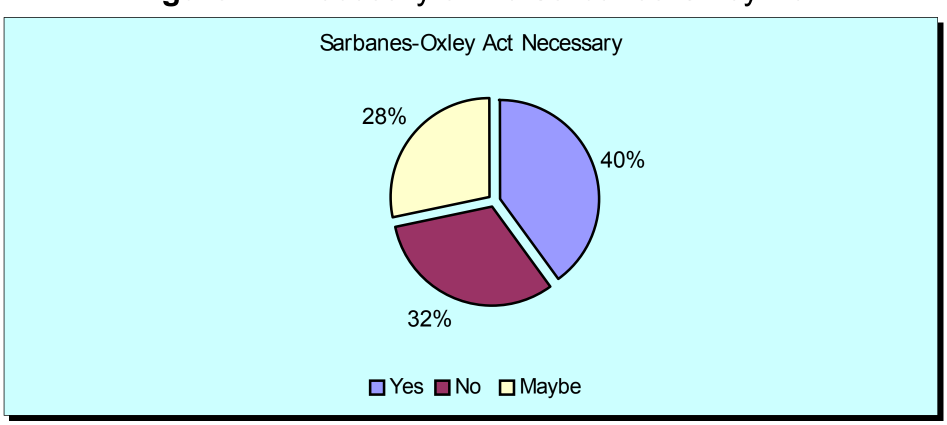


A total of 155 of the respondents (27%) were unsure of the effect of the new law on their practice.

One of the significant purposes of the Sarbanes-Oxley Act is to improve both corporate and investor confidence. Respondents were asked if they believed the new laws would improve corporate and investor confidence. Respondents were undecided regarding the confidence questions. Of the 584 respondents, roughly one third answered yes, one third no and one third maybe.

A total of 233 respondents (40%) believe that the Sarbanes-Oxley Act is a necessary law. Another 165 respondents (28%) believe that the law is probably necessary. A total of 186 respondents (32%) do not believe the new law is necessary.

Figure 12. Necessity of the Sarbanes-Oxley Act



It is interesting to note that 398 respondents (68%) - in a primarily self-regulated industry (until this law was passed) – believe the Sarbanes-Oxley Act was either necessary or probably necessary.

Briefing with the Act's Authors

On November 14, 2002, in Washington, D.C., at the United States Senate Banking Committee Offices, a briefing of the results of this research project was provided to Senator Sarbanes and Congressman Oxley, through their representatives, Committee attorneys (and the actual authors of the Sarbanes-Oxley Act, Dean Shahinian, J.D., and Vincent Meehan, J.D). Both were tremendously interested in the findings, and asked for a copy of the report from this research project.

Conclusion

This research project has been exceptionally interesting. It is clearly the first study of its kind of CPAs and their defining moments before the passage of the Sarbanes-Oxley Act, as well as their perception of the new law. The response rate by the participants reaffirms the importance of the issues contained in the Act.

Results

On its "face," the research project failed to prove the hypothesis. A total of 33% of the respondents would have been necessary in the circumvention of GAAP category, and a total of 50% of the respondents would have been necessary in the "aggressively push" GAAP category to do so. While the percentage for the circumvention of GAAP was very close at 31%, the percentage for "aggressively" pushing GAAP was significantly lower than perceived, missing the threshold by 19%. However, it is a significant and important discovery that CPAs have been solicited by corporate leaders to either circumvent or aggressively push GAAP standards in both public and private companies. While the response rate did not achieve 50%, it did receive a good number of responses from more than 500 individuals.

While the Sarbanes-Oxley Act specifically addresses only publicly-held companies, the survey results expose a significant need for some type of assistance for private companies as well. It will be interesting to observe if new accounting standards are developed for use by private companies.

Critique of Validity and Reliability

One of the most important validity threats in this research project is assuring that the conceptual definitions and operations are valid. Until these findings can be retested, the extent of the threat will remain unknown.

As time goes on, issues regarding other corporate failures and familiarization with the Sarbanes-Oxley Act will influence respondent decisions. It would be interesting to select another state or geographical region as the population base. A collateral research project might be to survey CEOs and CFOs on matters relating to the circumvention of

GAAP. Taking the results of this research project at face value, it is those individuals who are clearly responsible for the lack of transparency in financial reporting, and for creating the need for the Sarbanes-Oxley Act.

Was the Sarbanes-Oxley Act Necessary?

According to the respondents, 40% admit the law was necessary, while another 28% reveal that the law was probably necessary. The researchers and authors of this research project agree that the Sarbanes-Oxley Act was necessary and concur with a statement made by President George W. Bush, "The Act adopts tough new provisions to deter and punish corporate and accounting fraud and corruption, ensures justice for wrongdoers, and protects the interests of workers and shareholders" (The White House, 2002 July 30).

So, are the CPAs, the authors of this research project and the President correct? It is too early to know for sure. Only time will tell.

About the Authors

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Angela La See is a licensed private investigator who specializes in training companies, law firms, and government entities to analyze information contained in public filings and other publicly-available information, and integrate it into their fraud research through ad hoc and automated solutions. La See has worked in the United States and Hong Kong. She is a student member of the Association of Certified Fraud Examiners and the American Criminology Society.

Kyungseok Choo, Ph.D., is an assistant professor of criminal justice at Utica College. He teaches “Research and Analytical Methods” in the Economic Crime Management graduate program. As a member of the American Society of Criminology and the Academy of Criminal Justice Science, he has presented various research papers at major conferences. He earned a Master of Science degree from the College of Criminal Justice at Northeastern University and completed his Ph.D. dissertation at the School of Criminal Justice at Rutgers University.

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Appendix 1

Utica College of Syracuse University

R. A. (Andy) Wilson, CFE, CPP and Angela La See
c/o WTI, 5350 Poplar Avenue, Suite 308, Memphis, TN 38119
(901) 763-0711 or (925) 202-4402

Dear California Licensed Certified Public Accountant:

We are graduate students conducting a survey for an applied research course, *Research and Analytical Methods in Fraud Management*, at Utica College of Syracuse University. Our choice of topic was inspired by the passage of the Sarbanes-Oxley Act, and the increased media attention on corporate business practices.

Corporate business failures such as Enron, WorldCom and Arthur Andersen, encouraged Senator Paul Sarbanes (D-Maryland) and Congressman Mike Oxley (R-Ohio) to sponsor the Act targeting corporate responsibility. Signed into law July 30, 2002, the Act calls for an accounting oversight board, toughens penalties against executives who commit corporate fraud and increases the authority of and funding for the Securities and Exchange Commission.

The new law will likely have implications for the accounting profession and your participation in the enclosed survey would be greatly appreciated. It is a blind survey - the results will be collected and compiled so that responses cannot be attributed to the respondent.

We thank you in advance for your participation. Should you wish to view the results, we will have our findings available by December 15, 2002 at the following Utica College website:

http://webserv.ucsu.edu/crimjus/ecmcpasurvey.

Please complete and mail the pre-paid reply card by October 31, 2002.

Thank you again,

R. A. (Andy) Wilson, CFE, CPP Angela La See

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Appendix 2

AN ACCOUNTANT'S DEFINING MOMENTS: QUESTIONABLE CORPORATE PRACTICES BEFORE & AFTER THE SARBANES-OXLEY ACT OF 2002

Position? Years in profession? □ 1-5 □ 6-12 □ 13-19 □ 20+

In a professional capacity as a Certified Public Accountant . . .

1. Within the last 5 years been solicited by a corporate client to circumvent GAAP? □ Yes □ No □ Maybe
2. What was the position/title of the individual making such request? □ CEO □ CFO □ __________
3. What was the type of business? □ Public □ Private □ __________
4. What was the employee size of this business? □ 1,000 or more □ 101-999 □ 100 or less
5. Did you comply with this request? □ Yes □ No □ Maybe
6. Has this occurred on more that one occasion? □ Yes □ No □ #________

7. Within the last 5 years, been solicited by a corporate client to "aggressively" push GAAP (to the limits)?
8. What was the position/title of the individual making such request?
9. What was the type of business?
10. What was the employee size of this business?
11. Did you comply with this request?
12. Has this occurred on more than one occasion?

13. Will the Sarbanes-Oxley Act affect your accounting practice?
14. Will the Sarbanes-Oxley Act improve corporate confidence?
15. Will the Sarbanes-Oxley Act improve investor confidence?
16. Was the Sarbanes-Oxley Act really necessary?

Thank you for your participation.